

RD AN 4146 (4287-B)/(4280-B)
February 23, 2006

SUBJECT: Business and Industry Guaranteed and Direct Loan Programs
and Section 9006 Renewable Energy Systems and Energy Efficiency
Improvements Guaranteed Loan Program – Full Faith and Credit

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

This Administrative Notice (AN) is being issued to provide guidance on responding to issues related to fraud and/or misrepresentation and reduction of request for loss claim based on documented lender negligence. It is important that Agency officials understand how to respond to loss claims.

COMPARISON WITH PREVIOUS AN:

There is no previous AN.

IMPLEMENTATION RESPONSIBILITIES:

Form RD 4279-4, “Lender’s Agreement,” section I, B. Full Faith and Credit states: “The guarantee is supported by the full faith and credit of the United States and is incontestable except under the circumstances of fraud or misrepresentation of which the Lender has actual knowledge at the execution of the guarantee or of which the Lender participates in or condones.

The Loan Note Guarantee will be unenforceable by the Lender to the extent any loss is occasioned by violation of usury laws, negligent servicing, or failure to obtain the required security regardless of the time at which USDA acquires knowledge of the foregoing. Any losses will be unenforceable by the Lender to the extent that loan funds

EXPIRATION DATE:
February 28, 2007

FILING INSTRUCTIONS:
Preceding RD Instructions 4287-B and 4280-B

are used for purposes other than those specifically approved by USDA in its Conditional Commitment for Guarantee. Negligent servicing is defined as the failure to perform those services which a reasonably prudent Lender would perform in servicing its own portfolio of loans that are not guaranteed. The term includes not only the concept of a failure to act but also not acting in a timely manner or acting in a manner contrary to the manner in which a reasonably prudent Lender would act up to the time of loan maturity or until a final loss is paid.”

Fraud or Misrepresentation - Level of Proof

When the Agency determines that there is sufficient evidence of fraud or misrepresentation, then and only then, is there a basis for determining the Loan Note Guarantee is unenforceable. The threshold for fraud or misrepresentation is high and difficult to prove. In general, fraud must be proven by clear and convincing evidence, which is lower than the criminal standard of beyond a reasonable doubt, but higher than the civil standard of more likely than not.

Fraud or Misrepresentation - Generally What Must be Proven

The Government will likely have to prove that the fraudulent representation made by the Lender was intentional and not negligent. The Government will also likely be expected to establish that the Lender knew the representation was false or that the Lender made the representation without having knowledge of its truth. Nondisclosure of information can amount to a false representation, if a transaction is based on the existence of a particular fact and the Government is not informed that material circumstances have changed with regard to that particular fact. Further the Government would likely be expected to show that the representation concerned a material fact. For the Business and Industry and Section 9006 programs, this would be a representation of a fact that individually or cumulatively would have caused the Government to not issue the guarantee. Additionally, the Government would likely have to prove that the intent of the representation was to cause the Government to issue the Business and Industry loan which the Government ultimately did. These elements are provided as an illustrative (and not exhaustive) list to highlight that proving fraud or misrepresentation is very difficult. It is also important to not confuse or interchange fraud or misrepresentation with negligent servicing and the remedies related to each (denying the guarantee for fraud or misrepresentation versus reducing the guarantee for negligent servicing). If you believe the guarantee should be terminated because of fraud or misrepresentation, you should consult with your Regional Office of the General Counsel (OGC) office. If the conclusion is to proceed on this ground, then the Lender should be notified immediately.

Negligent Servicing - Level of Proof

In order to prevail in a case alleging negligent servicing, the Government will need to prove its case by the ‘more likely than not’ civil standard. This is a far easier standard than that for fraud or misrepresentation.

Negligent Servicing - Generally What Must be Proven

In order to prevail the Government will have to prove that the Lender had a duty to take a certain action which he failed to perform or failed to adequately perform. This duty is established in the regulations by the general reference to what a reasonable lender would have done. The Lender's failure to meet this standard must have caused a loss to the Government. Again this list of what the Government must prove is illustrative and not exhaustive.

When there is negligent servicing the loan guarantee is reduced by the amount of the associated loss. Therefore, there must be some way of quantifying the loss. This latter requirement is not always easy to prove. For instance, assume the Lender fails to assure that the insurance premiums are paid and the policy is cancelled. If a subsequent fire causes \$50,000 in damage to a building that serves as collateral, then the loss could be reduced accordingly. However, what if the Lender failed to timely obtain periodic reports that a reasonable lender would have obtained and that would have shown the company was not performing as expected. Calculating the amount of any resulting loss in this case could prove very difficult.

Keep in mind that the Agency cannot terminate the guarantee because of negligent servicing. However, the Agency can reduce a loss claim payable to the Lender under the guarantee to the extent of loss caused by the Lender's negligence. In some instances, this reduction may even be for the full amount of the guarantee. Again you should consult with your Regional OGC office before proceeding with a reduction of the guarantee. Once a decision to reduce the claim has been made, you should notify the Lender immediately.

If you have any questions on the information provided, please contact the Loan Servicing Branch at, (202) 690-4103.

(Signed by Jackie J. Gleason)

JACKIE J. GLEASON
Acting Administrator
Business and Cooperative Programs